United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

76-5012

To be argued by
MICHAEL WEXELBAUM

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-5012

B P/S

In re ORE CARGO, INC.,

Bankrupt.

ISRAEL DISCOUNT BANK LIMITED,
Plaintiff-Appellant,

—v.—

JACOB GOTTESMAN, Trustee in Bankruptcy of ORE CARGO, INC.,
Defendant-Appellee.

BRIEF OF DEFENDANT-APPELLEE

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Preliminary Statement

This brief is submitted by Defendant-Appellee, Jacob Gottesman, Trustee in Bankruptcy of Ore Cargo, Inc. ("Trustee"), in support of the Order of Honorable Kevin T. Duffy, Judge, dated December 31, 1975, and entered January 6, 1976, affirming the Order of Honorable Asa S. Herzog, Bankruptcy Judge, dated May 12, 1975, which granted the Trustee's motion to dismiss the complaint in the reclamation proceeding instituted by Plaintiff-Appellant, Israel Discount Bank Limited ("Israel").

Question Presented

1. Were the courts below correct in determining that the Plaintiff-Appellant did not obtain a security interest in the proceeds of the tort claim at issue pursuant to the General Security Agreement entered into by the Bankrupt?

Facts

The case at bar involves a reclamation proceeding instituted in the Bankruptcy Court by Israel to recover, among other things, the sum of $20,968.16 then in the possession of the Trustee. As it was demonstrated to the Bankruptcy Court that these monies (plus accrued interest less disbursements) constitute the only assets of the Bankrupt that have come into the possession of the Trustee to date, Israel's claim for reclamation in the instant proceeding can only be directed against these monies.

The proceeding in the Bankruptcy Court was commenced by the service of a Summons and Notice of Trial and Complaint upon the Trustee. Prior to answering said Complaint, the Trustee brought on a motion for an order dismissing the reclamation proceeding on the grounds that the Complaint failed to state a claim upon which relief could be granted, and in the alternative, for an order granting summary judgment in favor of the Trustee on the grounds that there was no genuine issue as to any material fact. The Bankruptcy Court treated the application as a motion for summary judgment.

An involuntary petition in bankruptcy was filed against the Bankrupt on September 25, 1972. The Bankrupt was adjudicated bankrupt on October 11, 1972. A list of creditors of the Bankrupt filed in or about October, 1972, duly listed Israel as a creditor. Pursuant to a notice to creditors dated November 2, 1972 sent out by

the Bankruptcy Court, the first meeting of creditors of the Bankrupt was held on November 17, 1972. At said meeting the Trustee herein was duly elected to serve in such capacity. The deadline for filing claims in the bankruptcy proceeding was May 17, 1973, and said date passed without any claim having been filed by Israel.

The first written communication between Israel and the Trustee was by letter dated April 27, 1973, sent to the attorneys for the Trustee by the attorneys for Israel. By said letter, the Trustee was advised that Israel "is a secured creditor of the above-named bankrupt by reason of having been the first preferred mortgagee of the former *SS John Crosby* and of being the loss payee of the marine insurance policies on said vessel, as well as a named assured . . ." (Paragraph 13 of moving affidavit of Michael Wexelbaum, sworn to on January 20, 1975 and Exhibit D annexed thereto.)

Thereafter, Israel's attorneys sent another letter, dated November 14, 1974, to the attorneys for the Trustee, advising that Israel was allegedly the "assignee" of all claims of the Bankrupt, and demanding payment "of the sum of $20,968.16 representing the proceedings of a collision claim formerly owned by Ore Cargo, Inc." Said letter alleged in relevant part that "This claim, as well as all other claims owned by Ore Cargo, Inc., was assigned to our client, Israel Discount Bank Limited, on January 15, 1971, to secure obligations still outstanding . . . . by an assignment of which a copy is enclosed. Due notice of our client's security interest was given to the world by filing under the Uniform Commercial Code." (Paragraphs 17 and 18 of the moving affidavit of Michael Wexelbaum and Exhibit E annexed thereto.) The purported "assignment" enclosed with the aforesaid letter dated November 14, 1974, proves to be exactly what it is entitled—i.e., a "General Security Agreement"—and not an assignment. (Appendix, pp. 2-5).

At the time of the service of Israel's complaint herein, the only two documents of which the trustee had knowledge were the First Preferred Mortgage held by Israel as mortgagee on the bankrupt's vessel, *ss John Crosby*, and the General Security Agreement forwarded to the Trustee's attorneys on November 14, 1974. Furthermore, in paragraph 2 of the Complaint, Israel alleged that "at all times since January 15, 1971, plaintiff has been and now is the holder of a *perfected security interest* in all . . . claims . . . of Ore Cargo, Inc., the bankrupt herein, and the proceeds thereof." Accordingly, due to the fact that the only property of the Bankrupt presently in the possession of the Trustee is the proceeds of a tort claim arising out of a collision between the Bankrupt's vessel and another vessel known as the *Haslach*, the Trustee predicated his motion to dismiss the Complaint upon Section 9-104(k) of the Uniform Commercial Code, which excludes claims arising out of tort from the provisions of Article 9 of the U.C.C.

The moving papers of the Trustee took the position that as the proceeds of the tort claim in the possession of the Trustee were not subject to a security interest obtained under the Uniform Commercial Code, Israel could not have obtained a valid security interest therein pursuant to the General Security Agreement entered into by the Bankrupt. The Trustee contended that the fact that due notice of Israel's alleged security interest was "given to the world" by filing under the U.C.C. was of no import.

In its answering papers, Israel included a new document, the existence of which was previously totally unknown to the Trustee, to wit: a "General Assignment". (Exhibit 3 annexed to the affidavits in opposition of J. Lester Parsons, III, sworn to on February 13, 1975 and John G. Manos, sworn to on February 10, 1975). The affidavits in opposition submitted by Israel claimed that

its alleged security interest was obtained under any one or more of the three separate documents finally before the court (i.e., the "General Security Agreement", the "General Assignment", and the "First Preferred Mortgage" [Exhibit 4 annexed to the affidavits in opposition]). Accordingly, the reply papers submitted to the Bankruptcy Court by the Trustee dealt with all three of said documents and disposed of Israel's claim to the monies at issue under each of same.

The Bankruptcy Court found in favor of the position taken by the Trustee. Upon this appeal, Israel does not dispute that the Bankruptcy Judge was correct in finding and concluding that Israel did not obtain a security interest in, or an assignment of, the proceeds of the Bankrupt's tort claim, pursuant to the General Assignment and the First Preferred Mortgage (see p. 7 of Plaintiff-Appellant's Brief). Accordingly, the sole issue before this Court is whether the Bankruptcy Judge and the District Court were correct in holding that Israel did not obtain a security interest in the proceeds of the tort claim pursuant to the General Security Agreement.

ARGUMENT

POINT I

The Bankruptcy Judge And The District Court Were Correct In Holding That Israel Did Not Obtain A Security Interest In The Proceeds Of The Bankrupt's Tort Claim Pursuant To The General Security Agreement.

It has been established that all of the funds presently in the possession of the Trustee are the proceeds of the Bankrupt's claim for damages arising out of a collision between its vessel, the *John Crosby*, and another vessel, the *Haslach*. As the proceeds of a tort claim, these

monies are not subject to a security interest perfected under the Uniform Commercial Code. Section 9-104(k) of the Code provides:

> "§ 9-104. Transactions Excluded From Article. This Article does not apply .....
> .....
> (k) to a transfer in whole or in part of any of the following: any claim arising out of tort; ...."

In the Bankruptcy Court, Israel conceded that a tort claim and the proceeds thereof cannot be subject to a security interest obtained and perfected under the Uniform Commercial Code. (See Paragraph 10 of reply affidavit of Michael Wexelbaum, sworn to on March 12, 1975, where reference is made to Israel's memorandum of law submitted to the Bankruptcy Court, and p. 16 of transcript of oral argument held on March 14, 1975 [Appendix, p. 21]). Accordingly, before the Bankruptcy Court, Israel correctly argued that those transactions excluded from the operation of the U.C.C. by virtue of the provisions of Section 9-104 may still serve to secure an indebtedness under other applicable law. However, as was found by the Bankruptcy Judge, and as will be shown below, under the common law of New York, the only method by which a creditor can secure an indebtedness with a tort claim is to obtain an assignment thereof. Israel conceded that the tort claim at issue had not been expressly assigned to it by the Bankrupt. Therefore, in a desperate attempt to sustain the validity of its alleged security interest in the proceeds of the Bankrupt's tort claim, Israel urged the Bankruptcy Court to read an assignment of said tort claim into the General Security Agreement, either in conjunction with the First Preferred Mortgage and the General Assignment, or standing on its own. (See pp. 13 and 14 of transcript of oral argument. [Appendix, pp. 18-19]).

As the Bankruptcy Judge rejected the position taken by Israel, upon appealing to the District Court, and upon this appeal, Israel has taken a different tack. Israel is now contending that the common law has been so drastically influenced by the U.C.C. that for all practical purposes the Code has displaced the common law. Although conceding that Section 9-104(k) is "directly applicable to the facts" at bar (See p. 5 of Plaintiff-Appellant's Brief), Israel argues that the Courts should now hold that despite the exclusions set forth in Section 9-104, the provisions of the U.C.C. should be applicable herein, and pursuant thereto Israel should be found to have obtained a valid security interest in the tort claim at issue under the U.C.C.—oriented General Security Agreement. The position now taken by Israel is wholly without merit.

In discussing Section 9-104(k), Professor Gilmore said:

> "These exclusions . . . reflect the thought that such transfers are beyond the pale with respect to a statute devoted to commercial financing. The pre-Code common law of assignment or pledge will continue to apply to the excluded transfers; . . . ." Gilmore, *Security Interests in Personal Property*, Vol. I, p. 316 (1965).

Israel predicates its argument herein in large part upon the fact that Bankruptcy Judge Herzog quoted the aforesaid citation in his decision, and underlined the words "pre-Code common law of assignment" therein. Israel concedes that the General Security Agreement does not contain an "assignment" that is "sufficient under the 'pre-code common law of assignment'," and further concedes that it cannot "look elsewhere" for documents supporting its claim herein. (See p. 7 of Plaintiff-Appellant's Brief). However, Israel either fails to take cognizance of, or chooses to ignore, the

fact that the common law of assignment of the State of New York, as it is applicable to the case at bar, is the same today as it was prior to the adoption of the Uniform Commercial Code. Significantly, Israel has failed to cite even a single case holding that the pre-Code common law of assignment has been abandoned in favor of, or displaced by, the Uniform Commercial Code. Furthermore, it should be noted that Professor Gilmore's statement, published in 1965, was obviously written shortly after the U.C.C. was enacted (i.e., in New York, the U.C.C. was passed into law on April 18, 1962 and became effective on September 27, 1964). Therefore, it is specious to assume that by use of the phrase "pre-Code common law of assignment" Gilmore intended to exclude subsequent common law. Certainly Gilmore recognized that the common law is constantly evolving, and the quoted phrase should at this time, ten years or more after it was written, be read to mean "the common law of assignment, in effect prior to the adoption of the U.C.C. and as it evolves subsequent hereto." There is no evidence to support Israel's unfounded inference that Bankruptcy Judge Herzog ignored or overlooked the common law as it has developed since the U.C.C. went into effect. To the contrary, a number of the cases on assignment cited in the decision appealed from herein were handed down post-U.C.C. In addition, none of the cases on assignment cited by Bankruptcy Judge Herzog have been overruled.

Israel's contention that the provisions of the U.C.C. have "shattered" the common law of assignment (see p. 16 of Plaintiff-Appellant's Brief), ignores the relevant language of the Code itself. The third section of the U.C.C. states:

> "§ 1-103. Supplementary General Principles of Law Applicable
>
> Unless displaced by the particular provisions of this Act, the principles of law and equity, including

> the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankrutpcy, or other validating or invalidating cause shall supplement its provisions."

The aforesaid section clearly indicates the continued applicability of supplemental bodies of law (i.e., common law of assignment), except insofar as they are explicitly supplanted by the provisions of the Code.

In delineating the scope of Article 9 on Secured Transactions, Section 9-102 expressly limits the applicability of the provisions of said Article, as follows:

> "(1) *Except as otherwise provided* in Section 9-103 on multiple state transactions and *in Section 9-104 on excluded transactions*, this Article applies. . . ." (Emphasis added)

As was previously stated, the only method of obtaining a security interest in a tort claim is to obtain an assignment thereof. That an assignment creates a security interest is confirmed by Subdivision (2) of Section 9-102:

> "(2) This Article applies to security interests created by contract including pledge, *assignment*, chattel mortgage. . . ." (Emphasis added)

However, by virtue of Section 9-104(k), Article 9 does not apply to claims arising out of tort. Thus, the Code is not the legal channel to follow to obtain a security interest in a tort claim or the proceeds thereof. A security interest in a claim arising out of tort simply cannot be acquired by and through a security transaction engineered under the U.C.C. Having conceded this fact, Israel now indulges in a circuitous line of reasoning pursuant to which it claims that despite the exclusionary provisions of Section 9-104(k), a security interest in the tort claim at issue was granted to Israel pursuant to the following

language in Paragraph 2 of the General Security Agreement:

> "2. As security for the repayment of the obligations, the undersigned hereby grant(s) to the Bank a security interest in . . . all personal property . . . of the undersigned . . . of every kind and description tangible and intangible, including . . . all . . . general intangibles, credits, claims, demands and any other property, rights and interest of the undersigned, and the proceeds . . . thereof. . . ." (Appendix, p. 2)

Although it is true that "no specific or particular words are required to constitute an assignment", *Malone* v. *Bolstein*, 151 F. Supp. 544, 547 (N.D.N.Y. 1956), it must also be noted that:

> "While no special form of words is necessary to effect an assignment it is requisite that there be a perfected transaction between the parties, intended to vest in the assignee a present right in the things assigned. An assignment at law contemplates a completed transfer of the entire interest of the assignor in the particular subject of assignment, whereby the assignor is divested of all control over the thing assigned." *Coastal Commercial Corporation* v. *Samuel Kosoff & Sons, Inc.*, 10 A.D.2d 372, 376 (Fourth Dept. 1960).

See also:

Krause v. *Central Ins. Co. of Baltimore, et al.*, 40 N.Y.S.2d 736, 741 (Sup. Ct., Queens Cty., 1943).

Modern Kitchens of Syracuse, Inc. v. *Thomas Damiano, et al.*, 51 Misc.2d 264, 265 (Sup. Ct., Onondaga Cty., 1966).

Smith v. *City of New York*, 74 Misc.2d 723, 724 (Sup. Ct., Kings Cty., 1973).

In other words, an assignment vests title to the subject of the assignment in the assignee. (See New York General Obligations Law § 13-105.) In the case at bar, title to the tort claim at issue never vested in Israel, as the Bankrupt prosecuted said claim and received the proceeds thereof. Had this claim been assigned to Israel, the Bankrupt would no longer have been the real party in interest, and the claim would have had to have been prosecuted by Israel.

In addition, Israel completely ignores the fact that an essential element of an assignment is an *intent* to assign on the part of the assignor. *Advance Trading Corp.* v. *Nydegger*, 127 N.Y.S.2d 800, 801 (Sup. Ct., Bronx Cty., 1953); *Modern Kitchens of Syracuse, Inc.* v. *Thomas Damiano, et al.*, 51 Misc.2d 264, 265 (Sup. Ct., Onondaga Cty., 1966); *Malone* v. *Bolstein*, 151 F. Supp. 544, 547 (N.D.N.Y. 1956), aff'd. 244 F.2d 954 (2d Cir. 1957).

In Paragraph 4 of his affidavit in opposition, sworn to on February 10, 1975, John G. Manos, Senior Vice President of Israel, states that the Bankrupt never revealed the existence of its tort claim arising out of the collision between the *John Crosby* and the *Haslach* to Israel. An alleged assignment of a claim or cause of action *must* reveal an intention to part with ownership of and title to the chose by the assignor. *Globe Indemnity Co.* v. *Puget Sound Co., Inc., et al.*, 53 F. Supp. 51, 54 (W.DN.Y. 1943). Having failed to even mention the existence of the subject tort claim to Israel, it is self-evident that the Bankrupt had no intention of assigning it to Israel. Without this requisite element of intent, there cannot have been an assignment of the claim by the Bankrupt.

Manos' allegation that the financial statements of the Bankrupt which were submitted to Israel were false in failing to reflect the existence of the subject tort claim

(Paragraph 4 of his affidavit in opposition) is of no aid to Israel in this proceeding. The alleged fraudulent concealment of the tort claim was not perpetrated by the Trustee, whose sole interest and function is to protect the rights of all creditors of the Bankrupt by marshalling the assets of the Bankrupt's estate for distribution. A fraud perpetrated by a debtor does not create a security interest in favor of the defrauded party as against other creditors.

See: *Matter of Plotkin*, 56 Misc.2d 754, 760-761 (Surr. Ct., N.Y.Cty., 1968).

Furthermore, having had no knowledge of the existence of the Bankrupt's tort claim, Israel obviously did not rely upon it as security for the making of its loan to the Bankrupt. Hence, Israel cannot seriously contend that it is being deprived of any of its security.

In claiming that the General Security Agreement gives Israel a security interest in the tort claim despite the conceded lack of an assignment and regardless of Section 9-104(k) and the other applicable provisions of the Code, Israel ignores the fact that Paragraph 6 thereof explicitly states that "The Bank shall have the rights and remedies with respect to the Security of a secured party under the Uniform Commercial Code. . . ." (Appendix, p. 3). Pursuant to Section 9-104(k), the Bankrupt's tort claim was not part of the security extended by the General Security Agreement, and Israel's rights and remedies with respect thereto are non-existent under this instrument.

Israel points out that Paragraph 6 of the General Security Agreement also gives it certain specific rights in addition to those extended by the U.C.C. (See p. 9 of Plaintiff-Appellant's Brief.) However, nowhere therein is Israel given an assignment of the Bankrupt's tort claim. Therefore, in accordance with the maxim *expressio unius*

est exclusio alterius, Israel must look elsewhere for the assignment it seeks to establish here. As set forth above, Israel has now conceded that it has nowhere else to look.

The fact that this instrument is set forth on Israel's printed form is of further significance herein. As was noted by the Bankruptcy Judge, Israel is a sophisticated lender (See p. 14 of transcript of oral argument [Appendix, p. 19]), and "It is clear from the General Security Agreement that the draftsmen of that document did not intend to give Israel any more rights than a secured party would have obtained under the Uniform Commercial Code." (See p. 16 of Decision of Bankruptcy Judge Herzog [Appendix, p. 40]). Israel disagrees with the Bankruptcy Judge on this point, and contends that the language of Paragraph 2 of the General Security Agreement should be interpreted by the Court as creating a security interest in tort claims. (See pp. 7-8 of Plaintiff-Appellant's Brief). As the following exchange between the Bankruptcy Judge and Counsel for Israel during the oral argument demonstrates, Israel is really asking the Court to read into the General Security Agreement an assignment of tort claims that is nowhere to be found therein. On pp. 13-14 of the transcript of oral argument in the Bankruptcy Court (Appendix, pp. 18-19), the following appears:

> "Mr. Parsons: May it please your Honor, I have to concede there is no express assignment of this tort claim here.
>
> The Court: It has got to be read into the papers.
>
> Mr. Parsons: It has to be read into the papers.
>
> * * * * *

> The Court: If they were so aware of it why didn't they ever once use the word "tort" or "tort claim." This is a sophisticated party we are dealing with. You say it included everything including the tort claim, why didn't they somewhere, someplace, say this assignment would include all tort claims. They never did.
>
> Mr. Parsons: Your Honor, they didn't in the general . . . .
>
> The Court: What you are asking me to do is to read all documents and from their context to say that that was the intention of the parties.
>
> Mr. Parsons: Yes, your Honor.
>
> The Court: That is what you are asking me to do.
>
> Mr. Parsons: Yes, your Honor, ..."

Hence, Israel seeks to have the Court accomplish for it by implication what the bank's legal draftsmen failed to accomplish in the preparation of its General Security Agreement and the other security instruments signed by the Bankrupt. The Courts below refused to render any such assistance to this sophisticated lender, and it is respectfully submitted that their decision not to do so was correct. Assuming *arguendo* that there is some merit to Israel's argument that there are grounds for reading an assignment of tort claims into the General Security Agreement (a position that the Trustee vigorously disputes), at most this contention can only be said to raise a question of ambiguity concerning said document. As this agreement is set forth entirely on Israel's printed form, with absolutely no modifications, amendments or additions thereto having been made, any such ambiguity must be construed most strictly against Israel as the author of the instrument. The cases in

support of this "well-settled maxim" are legion. *Rentways, Inc.* v. *O'Neill Milk & Cream Co.*, 308 N.Y. 342, 348 (1955).

See also:

Mars Associates, Inc. & Normal Construction Corp. v. *Health and Mental Hygiene Facilities Improvement Corporation*, 47 A.D. 2d 5, 6, 364 N.Y.S. 2d 67 (Third Dept. 1975).

Ferber v. *Waco Trucking, Inc.*, 43 A.D. 2d 849, 351 N.Y.S. 2d 708 (Second Dept. 1974), reversed on other grounds, 36 N.Y. 2d 693, 366 N.Y.S. 2d 411.

Consolidated Gas Supply Corporation v. *Matula*, 42 A.D. 2d 656, 345 N.Y.S. 2d 206 (Third Dept. 1973).

Hodom v. *Stearns*, 32 A.D. 2d 234, 301 N.Y.S. 2d 146 (Fourth Dept. 1969), appeal dismissed, 25 N.Y. 2d 722, 307 N.Y.S. 2d 225.

General Venture Capital Corporation v. *Wilder Transportation, Inc.*, 26 A.D. 2d 173, 271 N.Y.S. 2d 805 (First Dept. 1966).

Israel's attempt to have this Court rectify its admitted failure to obtain an assignment of the Bankrupt's tort claim in its General Security Agreement is unworthy. For the Court to do so would be tantamount to its writing a new agreement between Israel and the Bankrupt. This the Court should not do. It is not the province of the Court to relieve a contracting party from the improvidence of his own acts. Sophisticated lenders should protect themselves, and not rely upon "boilerplate" from an inartistic or outmoded form.

The case of *Agar et al.* v. *Orda*, 264 N.Y. 248, 190 N.E. 479 (1934), cited at length on pp. 14-16 of Israel's

Brief, is inapposite. This case does not deal with the creation of a security interest in, or an assignment of, a claim arising out of tort. The analogy Israel attempts to draw between *Agar* and the case at bar doesn't hold, and should be rejected by this Court.

In brief, *Agar* dealt with the common law treatment of the sale of shares of stock, which were not included in the definition of "goods" set forth in the Uniform Sales Act. Nevertheless, the Court of Appeals held that the remedies of a seller of shares of stock should be limited to those available to a seller of goods under the Uniform Sales Act. However, the case at bar is clearly distinguishable by virtue of the fact that the U.C.C. specifically deals with claims arising out of tort, while the Uniform Sales Act was silent on the question of shares of stock. The import of this distinction was well put by Judge Martin Evans of the Civil Court of the City of New York in *Hertz Commercial Leasing Corporation* v. *Transportation Credit Clearing House, Inc. et al.*, 59 Misc. 2d 226, 298 N.Y.S. 2d 392 (Civil Ct., N.Y. Cty., 1969). The *Hertz* case dealt with the applicability of the implied warranties set forth in Article 2 of the U.C.C. on sales to an equipment lease. Judge Evans stated at 59 Misc. 2d 229-230:

> "That provisions of uniform acts have been extended to transactions which are *within their intent*, although perhaps not within their words, is clear. . . .
>
> "That the provisions of the Uniform Commercial Code may be extended by analogy to cases *within the intent of the code* has been foreseen by the Bar. . . ." (Emphasis added)

Claims arising out of tort are clearly not within the intent of the U.C.C. To the contrary, they are expressly excluded from the provisions thereof.

CONCLUSION

The Order of the Honorable Kevin T. Duffy, dated December 31, 1975, and entered January 6, 1976, affirming the Order of Honorable Asa S. Herzog, dated May 12, 1975, should be affirmed, with costs and counsel fees.

Respectfully submitted,

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